

CL 2050

November 5, 1999

Dear Applicant:

In response to your letter dated September 15, 1999, this is a letter ruling issued by the Director of Revenue pursuant to Section 536.021.9, Revised Statutes of Missouri ("RSMo"), and Administrative Regulation 12 CSR 10-1.020.

Your ruling request asked for guidance on a number of questions with respect to the qualified State tuition program (the "Program") established by the State of Missouri under Sections 166.400 to 166.455, RSMo (the "Statute"). You explained that the Program is designed to be a qualified State tuition program (a "QSTP") within the meaning of Section 529 of the Internal Revenue Code of 1986, as amended (the "Code"), and is intended to provide a method of saving for the expenses of higher education. You further explained that the Statute is designed to provide certain Missouri state tax benefits to those who participate in the Program and to the Program itself.

I. FACTS

The relevant facts, as you represented them, are as follows:

A. BACKGROUND

1. *The Statute*

Beginning in 1986, in order to promote access to higher education, a number of states enacted legislation creating college tuition savings plans aimed at providing individuals with a convenient method to fund the increasingly high cost of post-secondary education. By allowing account owners to make current contributions for designated beneficiaries and by investing these contributions with the goal of achieving a rate of return that reflects increases in educational costs, these programs were intended to provide designated beneficiaries with funds needed for the costs of their post-secondary school education.

Congress passed, and on August 20, 1996, President Clinton signed, the Small Business Job Protection Act of 1996, which provided, at Section 1806, that state-sponsored prepaid tuition and educational savings programs that met certain requirements would qualify as QSTPs and receive tax-exempt status. P.L. 104-188, 110 Stat. 1755, Section 1806. Section 1806 was codified as Section 529 of the Code ("Section 529").

To take advantage of the benefits afforded by Section 529, the State of Missouri enacted the Statute,¹ mandating and authorizing the implementation of the Program.

The Statute establishes the Board as an agency of the State of Missouri.² The Board will implement the Program by executing a Declaration of Trust (the "Declaration of Trust") prior to accepting contributions. The Board will be the sole trustee (the "Trustee") under the Declaration of Trust, and all governing powers thereunder will be vested in the Board. The Board has drafted an Emergency Rule, 12 CSR 50-4.020,³ under Section 166.415.1(2) of the Statute (the "Temporary Regulations"), which the Board has filed with the Missouri Secretary of State for issuance under emergency rulemaking

¹ House Bill No. 1694, 2nd Regular Session, 89th General Assembly (1998) as amended by Senate Bill No. 460, 1st Regular Session, 90th General Assembly (1999); (West's No. 39, 1999 Vernon's Missouri Legislative Service No. 2, 160-165).

² Statute, Section 166.415.1(2).

³ Missouri Register, Vol. 24, No. 19, pp. 2271-2275 (October 1, 1999).

procedures. The Temporary Regulations are expected to be promulgated by the Board as final regulations in substantially their current form.

The Statute provides that any person⁴ (an “Account Owner”), may make contributions on behalf of any individual designated “to benefit from payments for qualified higher education expenses at an eligible educational institution”⁵ (a “Beneficiary”) pursuant to the execution of a participation agreement (a “Participation Agreement”) establishing an account in the Program (a “Program Account”) between the Account Owner and the Board, as trustee.

As discussed below, the Statute establishes the Program so that it will meet the requirements of Section 529 and provides Missouri tax benefits and other rules specific to Missouri that are consistent with, but not required by, Section 529.

The rights and obligations of Account Owners and Beneficiaries are broadly defined in the Statute and are further detailed in the Temporary Regulations, the Declaration of Trust, the Participation Agreement and a disclosure document that describes the Program and that will be provided to all Account Owners (the “Program Disclosure Booklet”), which is incorporated by reference into and made a part of the Participation Agreement.

2. The Board

The Board is an agency of the State of Missouri, established by the Statute to administer the Program.⁶ The Board consists of the Missouri State Treasurer (who serves as chairman), the Commissioner of the Missouri State Department of Higher Education, the Commissioner of the Missouri State Office of Administration, the Director of the Missouri State Department of Economic Development and two persons with demonstrable experience and knowledge in the areas of finance or the investment and management of public funds, one of whom is selected by the President Pro Tem of the Missouri Senate and one of whom is selected by the Speaker of the Missouri House of Representatives. The two appointed members would serve for terms of four years, or until the appointment and qualification of their successors. The Statute does not provide for any compensation for Board members. The Board has the authority to promulgate reasonable rules and regulations that “permit the savings program to qualify as a ‘qualified state tuition program’ pursuant to Section 529 of the Internal Revenue Code and to ensure the savings program’s compliance with all applicable laws.”⁷

Among other powers, the Board is empowered and authorized under the Statute to: (1) develop and implement the Program; (2) promulgate rules, regulations and policies under the Statute; (3) develop and implement educational programs and related informational materials for Account Owners, either directly or through a contractual arrangement with a financial institution for investment services; (4) enter into agreements with any financial institution for the operation of the Program; (5) enter into Participation Agreements with Account Owners; (6) invest the funds received from Account Owners in appropriate investment instruments to achieve long-term total return through a combination of capital appreciation and fixed income; (7) make provision for the payment of costs of administration and operation of the Program; (8) delegate to its duly appointed investment counselor (who is or will be registered as an investment advisor with the Securities and Exchange Commission) authority to act in place of the Board in the investment and reinvestment of all or part of the Program funds and in the holding, purchasing, selling, assigning, transferring or disposing of any or all of the securities and investments in which Program funds have been invested, as well as the proceeds of such investments; and (9) effectuate and

⁴ The Temporary Regulations define “person” as “any individual, estate, association, trust, partnership, limited liability company, corporation, the State of Missouri or any department thereof, or any political subdivision of the State of Missouri.” Temporary Regulations, Section 2(C)11.

⁵ Statute, Section 166.410(1). Section 2(C)5 of the Temporary Regulations further defines “beneficiary” to mean “designated beneficiary” as defined in Section 529. See Code Section 529(e)(1).

⁶ Statute, Section 166.415.

⁷ Statute, Section 166.415.1(2).

carry out all powers granted by the Statute and have all other powers necessary to carry out and effectuate the purposes, objectives and provisions of the Statute pertaining to the Program.⁸

Pursuant to these powers and authority, the Board will execute the Declaration of Trust through which the Board will implement the Program. As explained below under “*The Role of the Board*,” the Board engaged TFI, an independent firm, to serve as program manager.

B. THE PROGRAM

1. General

The Program has two principal purposes: (1) to encourage savings to enable students to continue their education by attending eligible educational institutions, and (2) to enable Account Owners and Beneficiaries to avail themselves of tax benefits provided for QSTPs under the Code.⁹ The Statute provides that pursuant to the execution of a Participation Agreement by the Board, an Account Owner may make contributions on behalf of a Beneficiary for qualified higher education expenses at an eligible educational institution.

The Statute, the Temporary Regulations and the Participation Agreements have been drafted with the intent that, in the common case of an Account Owner who establishes a Program Account for a Beneficiary, makes withdrawals only for the Beneficiary’s qualified higher education expenses, and complies with the Program rules:

- 1) the Account Owner’s contributions to the Program Account will be subtracted from the Account Owner’s Missouri adjusted gross income, up to eight thousand dollars per year; and
- 2) such contributions and the earnings that accumulate in the Program Account thereon will not be subject to Missouri income tax.¹⁰

To participate in the Program, a prospective Account Owner will enter into a Participation Agreement with the Board. The Participation Agreement will provide that the Account Owner is to retain ownership of contributions made pursuant to the Participation Agreement and subject to the Declaration of Trust, and such contributions shall be invested by the Board as provided in the Participation Agreement. Pursuant to the Participation Agreement, an Account Owner will open a Program Account in the name of the Account Owner and for the benefit of a Beneficiary.¹¹ One or more Account Owners may establish Program Accounts for a single Beneficiary. The Participation Agreement will also provide for contributions to and withdrawals from the Program Account, subject to certain limitations. The Participation Agreement will specifically acknowledge that the Program is established with the intent that the Program qualifies for favorable tax treatment under Section 529 of the Code. In this regard, the Participation Agreement will provide that the Board may make any changes to the Program that may be required to obtain and retain the federal income tax treatment afforded under Section 529 of the Code.

In order for the Program to qualify as a QSTP under Section 529, the Statute, the Temporary Regulations and the Participation Agreements impose certain limitations on the rights of Account Owners and Beneficiaries. Account Owners may deposit only cash into a Program Account.¹² The Statute permits an Account Owner to cancel his or her Program Account and receive a refund of the deposited funds, but such a refund, and any other Nonqualified Distribution, is subject to a penalty (a “Withdrawal”

⁸ Statute, Section 166.415.

⁹ See Temporary Regulations, Section (3).

¹⁰ Statute, Section 166.435.1.

¹¹ Temporary Regulations, Section (5)(C).

¹² Temporary Regulations, Section (5)(D); Code Section 529(b)(2).

Penalty”) in compliance with Section 529.¹³ Each Participation Agreement will provide that no Account Owner or Beneficiary is permitted to direct the investment of any contribution or earnings on these contributions or pledge contributions or interest earned on a Program Account as collateral for a loan.¹⁴ The aggregate contributions to the Trust on behalf of a Beneficiary may not exceed a maximum investment level.¹⁵ The Statute also permits the Board to establish a maximum amount that may be contributed annually by an Account Owner to a Beneficiary.¹⁶ Participation in the Program does not guarantee that the Beneficiary will be admitted to an eligible educational institution, will be allowed to continue to attend an eligible educational institution after having been admitted or will graduate from an eligible educational institution.¹⁷

The Statute and the Temporary Regulations permit an Account Owner to make certain limited changes to the Program Account, consistent with the limitations of Section 529.¹⁸ An Account Owner may redesignate a Program Account for the benefit of a new Beneficiary who is a family member of the prior Beneficiary; such a redesignation will not be subject to state income tax.¹⁹ An Account Owner may also designate any other person (i.e., not a family member of the prior Beneficiary) eligible to be a Beneficiary, subject to a Withdrawal Penalty.²⁰ An Account Owner may transfer, in a rollover distribution (a “Rollover”), all or part of the funds in a Program Account to a Program Account for another Beneficiary who is a member of the family of the prior Beneficiary.²¹ If made to a family member of the Beneficiary, such a rollover is not subject to Missouri state income tax as a distribution²² and will not be subject to a Withdrawal Penalty.²³ The Temporary Regulations also permit a change in the ownership of a Program Account by allowing an Account Owner to transfer the ownership of a Program Account to another eligible Account Owner.²⁴ Individual Account Owners may also designate a “contingent Account Owner” in the event of the Account Owner’s death.²⁵

¹³ Statute, Section 166.430; Code Section 529(b)(3); Temporary Regulations, Section (6)(D). The Board will impose a Withdrawal Penalty “equal to or greater than ten percent of the earnings of an account for any distribution that is not (1) Used exclusively for qualified higher education expenses of the designated beneficiary; (2) Made because of the death or disability of the designated beneficiary; (3) Made because of the receipt of scholarship by the designated beneficiary; (4) A rollover distribution, as defined in section 529(c)(3)(C)(i) of the Internal Revenue Code; or (5) Held in the fund for the minimum length of time established by the Board.” Statute, Section 166.430; see also Temporary Regulations, Section (6)(D).

¹⁴ See Code Section 529(b)(5)-(6).

¹⁵ Statute, Section 166.420.3; Temporary Regulations, Section (5)(D); Code Section 529(b)(7). Section 166.420(2) of the Statute establishes a “total contribution limit” for Program Accounts to permit the Program to qualify as a QSTP under Section 529. Section (5)(D) of the Temporary Regulations provides that the total contributions that may be held in a Program Account shall be the amount established by the Board, “but in no event shall be more than the maximum amount permitted for the [Program] to qualify as a [QSTP] pursuant to Section 529. . . .”

¹⁶ Statute, Section 166.420.2; Temporary Regulations, Section (5)(D).

¹⁷ Statute, Section 166.420.1(3).

¹⁸ Temporary Regulations, Section 5.

¹⁹ Under Section 166.435 of the Statute, income earned in a Program Account is not subject to Missouri state income tax as long as the income is maintained, accrued or expended pursuant to the requirements of the Program, the Statute and Section 529. As discussed below, and under the Program, the Statute and Section 529, assets continue to be “maintained” in the Program despite a redesignation of the Beneficiary.

²⁰ Temporary Regulations, Section 5(F).

²¹ Temporary Regulations, Section 5(G).

²² Under Section 166.435 of the Statute, income earned in a Program Account is not subject to Missouri state income tax as long as the income is maintained, accrued or expended pursuant to the requirements of the Program, the Statute and Section 529. As discussed below, and under the Program, the Statute and Section 529, assets continue to be “maintained” in the Program despite a Rollover.

²³ See Temporary Regulations, Section 5(G).

²⁴ Temporary Regulations, Section 5(H). Any such transfer of Program Account ownership must meet requirements set forth in the Temporary Regulations, including requirements that any such ownership change 1) is irrevocable, 2) transfers total ownership of the Program Account, and 3) follows the administrative requirements of the Board for application of a change of ownership.

Section 166.435.2 of the Statute provides that if any deductible contributions to, or earnings from, any Program Account are distributed in a Nonqualified Distribution, the amount so distributed shall be added to the Missouri adjusted gross income of the Account Owner, or, if the Account Owner is not living, the Beneficiary.

Under the Statute, distributions for “qualified higher education expenses” (“Qualified Distributions”) are distributions to pay the Beneficiary’s qualified costs of tuition and fees and other expenses for attendance at an eligible educational institution, as defined in the Code.²⁶ The Temporary Regulations define “Qualified Withdrawal” to mean distribution from a Program Account used exclusively to pay qualified higher education expenses of the Beneficiary.²⁷ The Temporary Regulations define a Nonqualified Distribution as “a Distribution from an Account other than a Qualified Withdrawal, a Withdrawal Due to Death, Disability or Scholarship of a Beneficiary, a Rollover Distribution, or a Distribution from an Account that is made after amounts are held in such Account for the minimum length of time, if any, permitted by [Section 529] without the imposition of a penalty.”²⁸

2. *The Declaration of Trust*

Pursuant to powers vested in the Board by the Statute, the Board will enter into a Declaration of Trust for the Program, under which the Board is sole Trustee. The Board, as Trustee, will be ultimately responsible for the management of the investments pursuant to Statute and the Declaration of Trust. As noted above and consistent with the requirements of Section 529, no Account Owner or Beneficiary will be permitted to direct the investment of any contributions or the earnings on those contributions. Under the terms of the Declaration of Trust, the Board, as Trustee, will administer the Program, including maintaining accounts and records and providing annual reports to Account Owners.

3. *The Role of the Board*

As noted above, the Board will serve as sole trustee under the Declaration of Trust. In accordance with a Request for Proposal for implementation and management of the Program by a private investment manager, the State of Missouri (acting through the Office of Administration, Division of Purchasing and Materials Management) and the Board selected and approved TFI, a Delaware corporation, as the Program Manager. TFI is a wholly owned, indirect subsidiary of Teachers Insurance and Annuity Association (“TIAA”), a New York non-profit stock life insurance company.

The Board will approve marketing and promotional aspects of the Program and will have general oversight responsibilities for the operation of the Program on an ongoing basis.

II. RULINGS

The following are the responses to the questions contained in your ruling request.

Except as otherwise indicated, it is assumed that all Account Owners and Beneficiaries are qualified under the Statute and are in compliance with all relevant requirements of the Statute imposed on them. It is also assumed that the Program is established and operated in conformity and compliance with Section 529 and that the federal tax treatment accorded in Section 529 will be applicable to the Program, Account Owners and Beneficiaries. All requests and all responses are based upon one individual as Account Owner. No response contained herein is an application to a situation involving scholarship

²⁵ Id.

²⁶ Statute, Section 166.410(9).

²⁷ Temporary Regulations, Section (2)(C)12.

²⁸ Id.

accounts established for the benefit of one or more present or future beneficiaries pursuant to Temporary Regulations, Section (5)(C).

SITUATION A: ACCOUNT OWNER, A RESIDENT OF MISSOURI, ESTABLISHES A PROGRAM ACCOUNT FOR BENEFICIARY, WHO IS ALSO A MISSOURI RESIDENT.

Question 1: Will any portion of contributions made by Account Owner on behalf of Beneficiary be included in the gross income of Beneficiary for Missouri income tax purposes?

Conclusion: No portion of any contributions made by Account Owner to the Program Account will be included in Beneficiary's gross income for Missouri income tax purposes.

Legal Analysis: Section 143.121, RSMo, which defines "Missouri adjusted gross income," states that the Missouri adjusted gross income of a resident individual "shall be his federal adjusted gross income subject to the modifications in this section." Under Section 529, contributions to a QSTP account for the benefit of a Beneficiary are not included in the federal gross income of the Beneficiary. Code Section 529(c)(1). Section 143.121, RSMo, does not provide any modification for a resident individual's Missouri adjusted gross income as a result of a contribution to a Program Account. Accordingly, under Section 143.121, RSMo, no contribution by Account Owner to the Program Account will be included in the Missouri gross income or adjusted gross income of Beneficiary.

With respect to Account Owners other than individuals, the result is the same. See Section 143.431, RSMo (Missouri taxable income of corporations based on federal taxable income and subject to same Missouri adjustments used for individuals), Section 143.341, RSMo (Missouri taxable income of trusts and estates based on federal taxable income subject to Missouri adjustments that do not refer to Program Accounts), and Section 143.401, RSMo (partnerships generally not subject to tax).

Question 2: Will Account Owner receive a Missouri income tax deduction for any portion of the contributions he or she makes to the Program Account? Assume that Account Owner properly makes the contribution to the Program Account by mailing the contribution, and the postmark on the envelope is December 31 of the tax year for which Account Owner claims the tax deduction.

Conclusion: Contributions by Account Owner, who is an individual to the Program Account (together with contributions by this same Account Owner to other Program Accounts), up to a total of eight thousand dollars per year shall be subtracted in determining the Missouri adjusted gross income of such Account Owner. As long as a contribution is postmarked on or before the last day (December 31 in the case of a calendar year taxpayer) of the tax year for which Account Owner claims the deduction, the contribution is timely for purposes of claiming the deduction.

Legal Analysis: The last sentence of Section 166.435.1 of the Statute provides that "Annual contributions up to and including eight thousand dollars made to the program shall be subtracted from Missouri adjusted gross income pursuant to section 143.121, RSMo." Accordingly, a total of no more than eight thousand dollars may be deducted from the Missouri adjusted gross income of Account Owner, who is an individual even if such Account Owner contributes more than eight thousand dollars to the Program Account of Beneficiary or the Program Accounts of other Beneficiaries.

In the case of contributions by a partnership, S corporation or limited liability company which is treated as a partnership for Missouri income tax purposes, the contributions will flow through to the individual who is the partner, shareholder or member, respectively; provided however, any flow through contribution will be included in the aggregate of all contributions to Program Accounts in determining the eight thousand dollar maximum deduction for any individual. In the case of multiple tiers of partnerships, S corporations or limited liability companies, the contributions will flow through the intervening partnerships, S corporations and limited liability companies to the individual who is the partner, shareholder or member, respectively; provided however, any flow through contribution will be included in the aggregate of all contributions to Program Accounts in determining the eight thousand dollar maximum

deduction for any individual. Furthermore, no subtraction is allowed for any contribution by a corporation, association, trust, estate, the State of Missouri or any department thereof, or any political subdivision of the State of Missouri.

Question 3: Will any portion of the income earned in a Program Account under the Program prior to distribution be subject to Missouri income tax?

Conclusion: The income earned from investment of contributions and retained in a Program Account under the Program prior to distribution will not be subject to Missouri income tax for neither Account Owner nor Beneficiary.

Legal Analysis: Section 166.435.1 of the Statute states, "Income earned or received from the fund by any participant or beneficiary shall not be subject to state income tax The exemption from taxation pursuant to this section shall apply only to assets and income maintained, accrued or expended pursuant to the requirements of the [Program], the provisions of this section [Section 166.435.1] and [Section 529], and no exemption shall apply to assets and income expended for any other purposes." Prior to any distribution made from the Program Account, the income earned in the Program Account is "maintained or accrued" pursuant to the requirements of the Program, Section 166.435 of the Statute and Section 529, so the exemption from tax described in the preceding sentence applies to the income earned in the Program Account. Further under Section 529, income earned in a Program Account under the Program prior to distribution will not be included in federal adjusted gross income. Code Section 529(c)(1). Section 143.121, RSMo, does not provide any modification for a resident individual's Missouri adjusted gross income as a result of income earned in a Program Account prior to distribution.

With respect to Account Owners other than individuals, the result is the same. See Section 143.431, RSMo (Missouri taxable income of corporations based on federal taxable income and subject to same Missouri adjustments used for individuals), Section 143.341, RSMo (Missouri taxable income of trusts and estates based on federal taxable income subject to Missouri adjustments that do not refer to Program Accounts), and Section 143.401, RSMo (partnerships generally not subject to tax).

Question 4: Will any portion of a Qualified Distribution from the Program Account be subject to Missouri income tax?

Conclusion: No portion of a Qualified Distribution from the Program Account will be subject to Missouri income tax for either Account Owner or Beneficiary.

Legal Analysis: Section 166.435.1 of the Statute states, "Income earned or received from the fund by any participant or beneficiary shall not be subject to state income tax The exemption from taxation pursuant to this section shall apply only to assets and income maintained, accrued or expended pursuant to the requirements of the [Program], the provisions of this section [Section 166.435 of the Statute] and [Section 529], and no exemption shall apply to assets and income expended for any other purposes." A Qualified Distribution is expended pursuant to the requirements of the Program, Section 166.435 of the Statute and Section 529, so the exemption from tax described in the preceding sentence applies to the amount of the Qualified Distribution.

Under Section 529, the portion of a Qualified Distribution that is allocable to earnings is included in federal adjusted gross income of the Beneficiary as distributee. Accordingly, pursuant to Section 166.435.1 of the Statute, federal adjusted gross income will be reduced by the amount of such earnings to determine Missouri adjusted gross income.

Question 5: Will any portion of a Nonqualified Distribution from the Program Account be subject to Missouri income tax?

Conclusion: Under the Statute, the earnings portion of a Nonqualified Distribution, and any other portion of the Nonqualified Distribution that was properly deducted by the Account Owner in determining the Account Owner's Missouri adjusted gross income at the time the amount was contributed to the Program Account (a "Deducted Contribution"), are includible in the Missouri adjusted gross income of the Account Owner or, if the Account Owner is not living, the Beneficiary. Whether a contribution portion of a Nonqualified Distribution is comprised of Deducted Contributions or other contributions will be determined on the basis of a pro rata allocation based on the total amounts of Deducted Contributions and other contributions in the Program Account.

Legal Analysis: As detailed above in response to Question 1, contributions made to a Program Account are not included in the Beneficiary's federal adjusted gross income, even upon distribution, and therefore, under Section 143.121, RSMo, such contributions are not included in Missouri adjusted gross income. However, the exemption that applies to the earnings portion of a distribution under Section 166.435.1 for assets and income "maintained, accrued or expended" in the Program does not apply to income expended "for any other purpose," i.e., a Nonqualified Distribution. Under Code Section 529(c)(3)(A), the earnings portion of a Nonqualified Distribution is included in the gross income of the distributee, which may be either the Account Owner or the Beneficiary, depending upon the nature of the Nonqualified Distribution. See Proposed Treas. Reg. Section 1.529-1(c) (defining "distributee" as either an account owner or a designated beneficiary.) For Missouri income tax purposes, under Section 143.121, RSMo (or the relevant Sections of the Revised Statutes of Missouri for taxpayers other than individuals), the Missouri adjusted gross income of an individual or the Missouri taxable income of a corporation, trust or estate of the distributee will include the earnings portion of the Nonqualified Distribution.

Section 166.435.2 of the Statute states, "If any deductible contributions to or earnings from any savings account are distributed and not used to pay qualified higher education expenses or are not held for the minimum length of time established by the board, the amount so distributed shall be added to the Missouri adjusted gross income of the participant, or, if the participant is not living, the beneficiary." Consequently, the Deducted Contribution portion of a Nonqualified Distribution will be subject to Missouri income tax.

The Deducted Contribution portion of a Nonqualified Distribution will be added in determining Missouri adjusted gross income of Account Owner who is an individual. This is also the case when the Deducted Contribution portion of a Nonqualified Distribution flows through a partnership, S corporation or limited liability company which is treated like a partnership to an individual who is a partner, shareholder or member of the respective Account Owner.

Question 6: Will a distribution to Account Owner due to Beneficiary's death, disability or the receipt of a scholarship, or a distribution held in the Program for less than the minimum length of time established by the Board, be included in the gross income of Account Owner for purposes of Missouri income tax?

Conclusion: Under the Statute, in the case of a distribution to Account Owner due to Beneficiary's death, disability or the receipt of a scholarship, and in the case of a distribution of funds that have not been held in the program for a minimum period established by the Board (regardless of whether the funds not held for the minimum period are used for qualified higher education expenses), the earnings portion of any such distribution, and any Deducted Contributions included in the distribution, will be added to the Missouri adjusted gross income of the Account Owner or, if the Account Owner is not living, the Beneficiary.

Legal Analysis: Section 166.435.2 of the Statute provides that distributions not used to pay for qualified higher education expenses or not held for the "minimum length of time established by the board"

will be added to Missouri adjusted gross income. As described above, in response to Question 5, the earnings portion of such a distribution, and any portion of the distribution comprised of Deducted Contributions, will be included in the gross income of the Account Owner, or if the Account Owner is not living, the Beneficiary. This is also the case when the Deducted Contribution portion and the earnings flows through Account Owner which is a partnership, S corporation or limited liability company which is treated like a partnership to an individual who is a partner, shareholder or member of the respective Account Owner.

SITUATION B: ACCOUNT OWNER ESTABLISHES A PROGRAM ACCOUNT FOR BENEFICIARY. BENEFICIARY'S UNCLE ("UNCLE") WISHES TO CONTRIBUTE TO THIS PROGRAM ACCOUNT AND GIVES ACCOUNT OWNER A \$100 CHECK TO CONTRIBUTE TO THE PROGRAM ACCOUNT.

Question 7: Will \$100 be subtracted from Uncle's Missouri adjusted gross income?

Conclusion: One hundred dollars (\$100) will not be subtracted from Uncle's Missouri adjusted gross income.

Legal Analysis: Section 166.435.1 of the Statute provides that, "Annual contributions up to and including eight thousand dollars made to the savings program shall be subtracted from Missouri adjusted gross income pursuant to section 143.121, RSMo." This portion of the Statute is drafted to permit persons other than Account Owner to contribute to the Program Account, but only the Account Owner may subtract contributions from Missouri adjusted gross income. However, in the fact situation presented, Uncle did not contribute the \$100 to the Program, but instead gave it to Account Owner. The Statute does not provide any subtraction for gifts to Account Owners. It was Account Owner who made the contribution. Accordingly, Uncle's Missouri gross income will not be reduced by \$100 as a result of the \$100 gift to Account Owner. Uncle may establish his own Program Account, contribute the \$100 and subtract the contribution from Uncle's Missouri adjusted gross income.

SITUATION C: ACCOUNT OWNER ESTABLISHES TWO PROGRAM ACCOUNTS, ONE FOR ACCOUNT OWNER'S SON ("SON") AND ONE FOR ACCOUNT OWNER'S DAUGHTER ("DAUGHTER") ON JANUARY 1, 2000. IN 2000, ACCOUNT OWNER CONTRIBUTES \$8,000 TO SON'S PROGRAM ACCOUNT AND \$8,000 TO DAUGHTER'S PROGRAM ACCOUNT. SPOUSE, WHO IS MARRIED TO ACCOUNT OWNER, ALSO ESTABLISHES PROGRAM ACCOUNTS FOR SON AND DAUGHTER ON JANUARY 1, 2000. IN 2000, SPOUSE CONTRIBUTES \$10,000 TO SON'S PROGRAM ACCOUNT AND \$10,000 TO DAUGHTER'S PROGRAM ACCOUNT.

Question 8: How much will Account Owner and Spouse be entitled to deduct from their Missouri adjusted gross incomes? Will Account Owner and Spouse each have to have Missouri adjusted gross income at least equal to the amount of the deduction in order to take full advantage of the deduction?

Conclusion: If they file separate Missouri income tax returns, Account Owner and Spouse may each deduct \$8,000 in determining their Missouri adjusted gross incomes. If they file a combined Missouri income tax return, the couple may each deduct \$8,000 from each individual's Missouri adjusted gross income. In either case, Account Owner and Spouse must each have Missouri adjusted gross income of at least \$8,000 to subtract the full \$8,000 each has contributed.

Legal Analysis: Under Section 143.031, RSMo, a husband and wife, who file a joint federal income tax return, file a combined Missouri income tax return. Married couples, who file separate federal income tax returns, file separate Missouri returns.

Section 143.031, RSMo, provides that when a married couple files a combined return, the Missouri taxable income of each spouse is determined as a pro rata allocation in proportion to the Missouri adjusted gross income of that spouse. As described above in response to Question 2, the

maximum annual deduction an individual may take, regardless of the amount of their total contributions to Program Accounts for Beneficiaries in the Program is \$8,000. Because the combined reporting under Section 143.031, RSMo, results in each spouse effectively computing their Missouri adjusted gross income separately, the maximum that each spouse may deduct annually, regardless of total contributions to the Programs, is still \$8,000, and each spouse must have \$8,000 in Missouri adjusted gross income (whether earned or passive income) to benefit fully from the deduction. Provided they each have sufficient Missouri adjusted gross income, Account Owner and Spouse will subtract \$8,000 each, regardless of whether they file separate or combined Missouri returns.

SITUATION D: ACCOUNT OWNER ESTABLISHES A PROGRAM ACCOUNT FOR HER SON ("SON"). PRIOR TO SON RECEIVING ANY DISTRIBUTIONS FOR QUALIFIED EDUCATIONAL PURPOSES, ACCOUNT OWNER CANCELS HER PROGRAM ACCOUNT AND, WITHIN 60 DAYS, TRANSFERS THE FUNDS IN THE PROGRAM ACCOUNT (THE "ROLLOVER") INTO A PROGRAM ACCOUNT ESTABLISHED FOR ACCOUNT OWNER'S DAUGHTER ("DAUGHTER").

ALTERNATIVELY, INSTEAD OF CANCELING AND ROLLING OVER THE FUNDS IN THE PROGRAM ACCOUNT ESTABLISHED FOR SON, ACCOUNT OWNER REDESIGNATES SON'S PROGRAM ACCOUNT (THE "REDESIGNATION") TO MAKE DAUGHTER THE BENEFICIARY OF THE PROGRAM ACCOUNT.

Question 9: Will any portion of the amount of the Rollover or Redesignation be included in Missouri adjusted gross income of Account Owner, Son or Daughter for Missouri income tax purposes at the time the Rollover or Redesignation occurs, as a result of the Rollover or Redesignation?

Conclusion: No portion of the Rollover or Redesignation will be included in Missouri adjusted gross income of Account Owner, Son or Daughter for Missouri income tax purposes at the time the Rollover or Redesignation occurs, as a result of the Rollover or Redesignation.

Legal Analysis: Sections 5(F) and (G) of the Temporary Regulations permit, respectively, the Redesignation and Rollover described above. Under Code Section 529(c)(3)(C), no inclusion in the federal gross income of any person results from the Redesignation or the Rollover. As described above, in response to Question 1, under Section 143.121, RSMo (and related provisions of the RSMo for taxpayers other than individuals), if amounts are not included in federal gross income, they are not included in Missouri adjusted gross income. Accordingly, neither the Redesignation nor the Rollover will result in an inclusion in Account Owner, Son or Daughter's Missouri adjusted gross income.

While the Redesignation described above will not result in the imposition of Missouri tax, other redesignations permitted by the Temporary Regulations will result in Missouri income tax. Temporary Regulations Section 5(F) permits redesignations of Program Accounts to persons other than a member of the family of the prior Beneficiary. Because such a redesignation would result in an inclusion of federal gross income of the distributee, the redesignation would also result in an inclusion in Missouri adjusted gross income.

SITUATION E: ACCOUNT OWNER ("GRANDMOTHER") ESTABLISHES A PROGRAM ACCOUNT ON BEHALF OF BENEFICIARY, HER GRANDSON ("GRANDSON"). AFTER ACTING AS ACCOUNT OWNER FOR THE PROGRAM ACCOUNT FOR SEVERAL YEARS, GRANDMOTHER TRANSFERS HER INTEREST IN THE PROGRAM ACCOUNT TO BENEFICIARY'S MOTHER ("MOTHER"), WHO HAS AGREED TO ACT AS THE ACCOUNT OWNER.

ALTERNATIVELY, GRANDMOTHER DOES NOT TRANSFER OWNERSHIP OF THE PROGRAM ACCOUNT. GRANDMOTHER DIES, AND MOTHER INHERITS HER ESTATE.

ALTERNATIVELY, PURSUANT TO PROGRAM RULES, GRANDMOTHER DESIGNATES MOTHER AS THE "CONTINGENT ACCOUNT OWNER," AND MOTHER BECOMES THE ACCOUNT OWNER AUTOMATICALLY UPON THE DEATH OF GRANDMOTHER.

Question 10: Will Grandmother, Mother or Grandson be required to include any portion of the funds in the Program Account in their gross income for Missouri tax purposes as a result of Grandmother's transfer of her ownership interest to Mother, or as a result of Grandmother's death and Mother's inheritance of the ownership interest in the Program Account, or as a result of Mother being named as the "contingent Account Owner" and automatically becoming the Account Owner on Grandmother's death?

Conclusion: Neither Grandmother, Mother nor Grandson will be required to include any portion of the funds in the Program Account in their gross income for Missouri tax purposes as a result of the change (by transfer, inheritance or automatic transfer to a "contingent Account Owner") in the ownership of the Program Account.

Legal Analysis: Section (5)(H) of the Temporary Regulations permits changes in the ownership of a Program Account by transfer and by designation of a contingent Account Owner. The Temporary Regulations provide that the new Account Owner, "shall be considered the Account Owner for all purposes related to the Savings Program" Temporary Regulations, Section (5)(H). Under Section 529, the Beneficiary of a Program Account is deemed to have received a completed gift of the funds in the Program Account, and therefore, as long as those funds are held in the Program Account for the same Beneficiary, there should be no deemed distribution. See Prop. Reg. Section 1.529-5(b). Under Section 166.435.1 of the Statute, the exemption from Missouri income tax applies "only to assets maintained, accrued or expended" pursuant to the Program, the Statute and Section 529, and assets within Program Accounts continue to be "maintained" and "accrued" despite a change in Account Ownership. Accordingly, neither Grandmother, Mother nor Grandson will be required to make such an inclusion in gross income for Missouri tax purposes.

If, however, following the change in Program Account ownership, Mother cancelled the Program Account and received a Nonqualified Distribution, Mother would be required to include in federal adjusted gross income and, accordingly, Missouri adjusted gross income, all of the earnings that accumulated within the Program Account, including earnings that accrued during the period when Grandmother was the Account Owner and all Deducted Contributions, including Deducted Contributions made to the Program Account by Grandmother. See Temporary Regulations, Section (5)(H) ("[T]he transferee shall be considered the Account Owner for all purposes related to the Savings Program")

SITUATION F: ACCOUNT OWNER ESTABLISHES A PROGRAM ACCOUNT ON BEHALF OF BENEFICIARY. ACCOUNT OWNER DIES, AND NEW OWNER BECOMES THE OWNER OF THE PROGRAM ACCOUNT. NEW OWNER SUBSEQUENTLY MAKES A NONQUALIFIED WITHDRAWAL FOR NEW OWNER'S OWN PURPOSES, UNRELATED TO BENEFICIARY.

Question 11: Will any portion of the Nonqualified Distribution be included in the Missouri gross income of New Owner or Beneficiary?

Conclusion: The earnings portion of the Nonqualified Distribution, and any Deducted Contributions included in the Nonqualified Distribution, will be added to the Missouri adjusted gross income of New Owner. No amount will be included in the Missouri adjusted gross income of Beneficiary.

Legal Analysis: Under Section 529, because New Owner is the distributee of a Nonqualified Distribution, the earnings portion of the Nonqualified Distribution will be included in the federal adjusted gross income of New Owner. Code Section 529(c)(3)(A). Because these amounts are included in New Owner's federal adjusted gross income, they will also be included in New Owner's Missouri adjusted gross income.

Under Section 166.435.2 of the Statute, "deductible contributions to or earnings from any savings account" distributed in a Nonqualified Distribution are added to the Missouri adjusted gross income of "the [Account Owner], or if the [Account Owner] is not living, the [Beneficiary.]" Because the original account owner is not living, the Statute could be read to provide that the earnings portion and the Deducted

Contributions portion included in the Nonqualified Distributions will be added to Beneficiary's Missouri adjusted gross income. The question becomes when does Section 166.435.2 of the Statute apply: is it at the time the Program Account is established or is it at the time of the Nonqualified Distribution?

However, as described in the preceding paragraph, Missouri law already requires that the earnings portion be included in New Owner's Missouri adjusted gross income. Interpreting the Statute to require that both New Owner and Beneficiary must include the earnings portion of the Nonqualified Distribution in Missouri adjusted gross income would mean that the same income was simultaneously earned by two persons.

In construing statutes, the goal is to effectuate the intent of the legislature. *Union Electric Co. v. Director of Revenue*, 799 S.W.2d 78, 79 (Mo. banc 1990). Section 166.435.2 of the Statute provides the Nonqualified Distribution "shall be added to the Missouri adjusted gross income of the participant, or, if the participant is not living, the beneficiary. The Temporary Regulations, Section (5)(H) provide "the transferee shall be considered the Account Owner for all purposes related to the Savings Program" In this situation Account Owner dies before the Nonqualified Distribution is issued and the Nonqualified Distribution is issued to New Owner. It is clear New Owner is the "participant," i.e., the owner of the account, when the Nonqualified Distribution is made. The deductible contributions portion of the Nonqualified Distribution is properly included in the Missouri adjusted gross income of New Owner.

Code Section 529(c)(3) includes the earnings portion of a Nonqualified Distribution in the federal gross income of the "distributee" of the distribution. The proposed Treasury Regulations under Section 529 define "distributee" to mean, "the designated beneficiary or the account owner who receives or is treated as receiving a distribution from a QSTP." Accordingly, as the recipient of the Nonqualified Distribution and the "distributee" of the distribution as that term is defined for federal purposes, New Owner should include in Missouri adjusted gross income the earnings portion of the Nonqualified Distribution. Thus, New Owner should include both the earnings portion and the Deducted Contributions portion of the Nonqualified Distribution in Missouri adjusted gross. Beneficiary would not include any of the Nonqualified Distribution in his Missouri adjusted gross income. The estate of Account Owner would not include any the Nonqualified Distribution in the estate's gross income.

SITUATION G: ACCOUNT OWNER ESTABLISHES A PROGRAM ACCOUNT FOR BENEFICIARY. ACCOUNT OWNER THEN CANCELS THE PROGRAM ACCOUNT AND OBTAINS A REFUND THAT IS A NONQUALIFIED DISTRIBUTION. PURSUANT TO THE STATUTE AND THE TEMPORARY REGULATIONS, THE BOARD WITHHOLDS A PORTION OF THE NONQUALIFIED DISTRIBUTION AS A WITHDRAWAL PENALTY.

Question 12: Will the penalty amount of the distribution that is forfeited be included in Account Owner's Missouri adjusted gross income for Missouri income tax purposes? May Account Owner deduct the cost of the Nonqualified Distribution penalty from his or her gross income for Missouri income tax purposes?

Conclusion: The Withdrawal Penalty will not be included in Account Owner's Missouri adjusted gross income, and the Account Owner may not deduct the cost of the Withdrawal Penalty from his or her gross income.

Legal Analysis: Section 1.529-3(a)(1) of the proposed Treasury Regulations promulgated under Section 529 states, "If any amount of a distribution is forfeited under a QSTP as required by Section 1.529-2(e), this amount is neither included in the gross income of the distributee nor deductible by the distributee." As described above in response to Question 1, under Section 143.121, RSMo (and related sections for taxpayers that are not individuals), Missouri adjusted gross income is based on federal adjusted gross income, with limited additional adjustments. Amounts that are not reflected in federal adjusted gross income because they are neither includible in, nor deductible from, federal gross income will therefore not be reflected in Missouri adjusted gross income. Neither the Statute nor Section 143.121, RSMo, provides for the inclusion in Missouri adjusted gross income of a Withdrawal Penalty or

the deductibility of a Withdrawal Penalty. Accordingly, the Withdrawal Penalty will not be included in Account Owner's Missouri adjusted gross income nor deductible for Missouri income tax purposes.

SITUATION H: STATE A HAS A QSTP THAT MEETS ALL THE REQUIREMENTS OF SECTION 529. STATE A'S QSTP PERMITS ACCOUNT OWNERS TO "ROLLOVER" FUNDS FROM OTHER STATES' QSTPS INTO ITS QSTP. STATE A'S QSTP ALSO PERMITS ACCOUNT OWNERS TO ROLLOVER FUNDS FROM A BENEFICIARY'S ACCOUNT INTO AN ACCOUNT ESTABLISHED FOR A MEMBER OF THE FAMILY OF THE PRIOR BENEFICIARY WITHIN THE MEANING OF SECTION 529, OR TO REDESIGNATE ACCOUNTS TO NAME SUCH A FAMILY MEMBER AS THE NEW BENEFICIARY.

ACCOUNT OWNER, A RESIDENT OF MISSOURI, ESTABLISHES A PROGRAM ACCOUNT FOR HER SON ("SON"), WHO IS ALSO A MISSOURI RESIDENT. THREE YEARS LATER, ACCOUNT OWNER AND SON BOTH REMAIN IN MISSOURI, BUT ACCOUNT OWNER CANCELS HER PROGRAM ACCOUNT AND, WITHIN 60 DAYS, TRANSFERS THE FUNDS IN THE PROGRAM ACCOUNT INTO AN ACCOUNT ESTABLISHED IN STATE A'S QSTP FOR THE BENEFIT OF SON.

ALTERNATIVELY, ACCOUNT OWNER CANCELS HER PROGRAM ACCOUNT AND, WITHIN 60 DAYS, TRANSFERS THE FUNDS IN THE PROGRAM ACCOUNT INTO AN ACCOUNT ESTABLISHED IN STATE A'S QSTP FOR THE BENEFIT OF ACCOUNT OWNER'S DAUGHTER ("DAUGHTER"), WHO IS ALSO A MISSOURI RESIDENT AND REMAINS IN MISSOURI.

Question 13-1: Will any portion of the amount of the rollover to Son's account in State A's QSTP be included in the gross income of Account Owner or Son for Missouri income tax purposes?

Conclusion: The rollover to Son's account in State A's QSTP will be treated as a Nonqualified Distribution that will result in the portion of the distribution comprised of earnings derived from the Program Account and Deducted Contributions being included in the gross income of Account Owner for Missouri income tax purposes.

Legal Analysis: Code Section 529(c)(3)(C)(i) permits rollovers to "another designated beneficiary" (emphasis added). Section 1.529-1(c) of the proposed Treasury Regulations under Section 529 defines "rollover distribution" to mean, "a distribution or transfer from an account of a designated beneficiary that is transferred to or deposited within 60 days of the distribution into an account of another individual who is a member of the family of the designated beneficiary." The same section of the proposed Treasury Regulations provides that, "A distribution is not a rollover distribution unless there is a change in beneficiary. The new designated beneficiary's account may be in a QSTP in either the same State or a QSTP in another State." See also the preamble to the proposed Treasury Regulations, REG-106177-97, published in the Federal Register on August 24, 1998 (emphasis added).

Similarly, the Temporary Regulations state, "A Distribution is not a Rollover Distribution unless there is a change of Beneficiary. The account for such other Beneficiary may be an Account established under the [Program] or an account established under a [QSTP] in another State." Temporary Regulations, Section (2)(C)13.

Under Code Section 529(c)(3)(C)(i), a rollover does not result in the inclusion of income in federal gross income. Under Section 143.121, RSMo (and related sections for taxpayers that are not individuals), Missouri adjusted gross income is based on federal adjusted gross income, with limited additional adjustments, none of which apply to a rollover. Amounts that are not included in federal adjusted gross income will therefore not be reflected in Missouri adjusted gross income. Further, the funds included in a rollover continue to be "maintained" in a Program Account under Section 166.435.1 of the Statute, and are therefore exempt from Missouri taxation.

The transfer from Son's Program Account to Son's account in State A's QSTP is not a rollover because the transfer is not made to a new beneficiary. Accordingly, Son's account in State A's QSTP will be a Nonqualified Distribution that will result in the portion of the distribution comprised of earnings

derived from the Program Account, and the portion of the distribution comprised of Deducted Contributions, being included in the gross income of Account Owner for Missouri income tax purposes.

Question 13-2: Will any portion of the amount of the rollover to Daughter's account in State A's QSTP be included in the gross income of Account Owner, Son or Daughter for Missouri income tax purposes?

Conclusion: The rollover to Daughter's account in State A's QSTP will not result in any amount being included in the gross income of Account Owner, Son or Daughter for Missouri tax purposes.

Legal Analysis: Code Section 529(c)(3)(C)(i) permits rollovers to "another designated beneficiary" (emphasis added). Section 1.529-1(c) of the proposed Treasury Regulations under Section 529 defines "rollover distribution" to mean, "a distribution or transfer from an account of a designated beneficiary that is transferred to or deposited within 60 days of the distribution into an account of another individual who is a member of the family of the designated beneficiary." The same section of the proposed Treasury Regulations provides that, "A distribution is not a rollover distribution unless there is a change in beneficiary. The new designated beneficiary's account may be in a QSTP in either the same State or a QSTP in another State." See also the preamble to the proposed Treasury Regulations, REG-106177-97, published in the Federal Register on August 24, 1998 (emphasis added).

Similarly, the Temporary Regulations state, "A Distribution is not a Rollover Distribution unless there is a change of Beneficiary. The account for such other Beneficiary may be an Account established under the [Program] or an account established under a [QSTP] in another State." Temporary Regulations, Section 2(C)13.

Under Code Section 529(c)(3)(C)(i), a rollover does not result in the inclusion of income in federal gross income. Under Section 143.121, RSMo (and related sections for taxpayers that are not individuals), Missouri adjusted gross income is based on federal adjusted gross income, with limited additional adjustments, none of which apply to a rollover. Amounts that are not included in federal adjusted gross income will therefore not be reflected in Missouri adjusted gross income. Further, the funds included in a rollover continue to be "maintained" in a Program Account under Section 166.435.1 of the Statute, and are therefore exempt from Missouri taxation.

The rollover from Son's Program Account to Daughter's account in State A's QSTP meets the federal and Missouri requirements of a rollover, despite the fact that the transfer is to another state's QSTP, because the transfer is made to a new beneficiary's QSTP account within 60 days, and the new beneficiary is a member of the family of the prior beneficiary. Accordingly, the transfer to Daughter's account in State A's QSTP will not result in any amounts being included in the gross income of Account Owner, Daughter or Son for Missouri income tax purposes.

SITUATION I: ACCOUNT OWNER, A RESIDENT OF STATE B, ESTABLISHES AN ACCOUNT FOR HIS SON ("SON"), WHO IS ALSO A STATE B RESIDENT, IN THE QSTP OF STATE B, WHICH MEETS ALL THE REQUIREMENTS OF SECTION 529. STATE B'S QSTP PERMITS PERSONS SUCH AS ACCOUNT OWNER TO ROLLOVER FUNDS TO OTHER STATES' QSTPS. ACCOUNT OWNER AND SON BOTH MOVE TO MISSOURI. THREE YEARS AFTER THE MOVE, ACCOUNT OWNER EFFECTS A ROLLOVER FROM THE STATE B QSTP TO THE PROGRAM FOR THE BENEFIT OF SON BY CANCELING HIS STATE B QSTP ACCOUNT AND DIRECTING THE STATE B QSTP TO DISBURSE THE FUNDS THEREIN WITHIN 60 DAYS TO A PROGRAM ACCOUNT THAT ACCOUNT OWNER HAS ESTABLISHED FOR SON.

ALTERNATIVELY, ACCOUNT OWNER ESTABLISHES A PROGRAM ACCOUNT FOR HIS DAUGHTER ("DAUGHTER") AND EFFECTS A SIMILAR ROLLOVER OF THE FUNDS IN SON'S STATE B QSTP ACCOUNT INTO THE PROGRAM ACCOUNT ESTABLISHED FOR DAUGHTER.

Question 14-1: Will any portion of the earnings within Son's account in the State B QSTP be included in the gross income of Account Owner or Son for Missouri income tax purposes, as such earnings accrue?

Conclusion: No portion of the earnings in Son's account in the State B QSTP will be included in the gross income of Account Owner or Son for Missouri income tax purposes, as such earnings accrue during the three years while Account Owner and Son are Missouri residents and the account is in State B QSTP.
Legal Analysis: Under Section 529, earnings on contributions in State B's accounts are not included in the federal gross income of Account Owner or Son for federal income tax purposes until a distribution is made from the account. Section 166.435.1, RSMo, provides "[t]he assets of the savings program held by the board and the assets of any similar savings program qualified pursuant to Section 529 of the Internal Revenue Code and any income therefrom shall be exempt from all taxation by the state or any of its political subdivisions." While Account Owner and Son are residents of Missouri and maintain the account in the QSTP of State B, none of the earnings of the account are included in Missouri gross income as long as the earnings remain in the account in the QSTP of State B.

Question 14-2: Will any portion of Nonqualified Distributions made from the State B QSTP account while Account Owner and Son live in Missouri be included in the Missouri gross income of Account Owner or Son?

Conclusion: A Nonqualified Distribution made from the State B QSTP account while Account Owner and Son live in Missouri will result in the portion of the distribution comprised of earnings derived from the State B QSTP and any Deducted Contributions being included in the gross income of Account Owner for Missouri income tax purposes.

Legal Analysis: Under Section 529, earnings on contributions in State B's accounts are not included in the federal gross income of Account Owner or Son for federal income tax purposes until a distribution is made from the account. Under Code Section 529(c)(3)(C)(i), qualifying rollovers are not includable in federal gross income. Because these earnings and rollovers are not included in the federal gross income of Account Owner or Son, under Section 143.121, RSMo, earnings in State B's QSTP will not be included in the gross income of Account Owner or Son for Missouri income tax purposes, as they accrue, and qualifying rollovers will not result in Missouri gross income. Conversely, because Nonqualified Distributions from State B's QSTP are included in the federal adjusted gross income of the distributee, these amounts will also be included in the Missouri adjusted gross income of Account Owner, or if Account Owner is not living, Son.

Question 14-3: Will any portion of the amount transferred from the QSTP of State B to the Program Account of Son be included in the gross income of Account Owner or Son for Missouri income tax purposes?

Conclusion: A Nonqualified Distribution made from the State B QSTP account while Account Owner and Son live in Missouri will result in the portion of the distribution comprised of earnings derived from the State B QSTP and any Deducted Contributions being included in the gross income of Account Owner for Missouri income tax purposes. The transfer to Son's Program Account will be treated as a Nonqualified Distribution that will result in the portion of the distribution comprised of earnings derived from the State B QSTP and any Deducted Contributions being included in the gross income of Account Owner for Missouri income tax purposes.

Legal Analysis: Under Section 529, earnings on contributions in State B's accounts are not included in the federal gross income of Account Owner or Son for federal income tax purposes until a distribution is made from the account. Under Code Section 529(c)(3)(C)(i), qualifying rollovers are not includable in federal gross income. Because these earnings and rollovers are not included in the federal gross income of Account Owner or Son, under Section 143.121, RSMo, earnings in State B's QSTP will

not be included in the gross income of Account Owner or Son for Missouri income tax purposes, as they accrue, and qualifying rollovers will not result in Missouri gross income. Conversely, because Nonqualified Distributions from State B's QSTP are included in the federal adjusted gross income of the distributee, these amounts will also be included in the Missouri adjusted gross income of Account Owner, or if Account Owner is not living, Son.

The proposed Treasury Regulations under Section 529 and the Temporary Regulations state that a transfer is only valid as a rollover if, in addition to being a timely transfer to a QSTP account, the transfer is made to a new beneficiary who is a member of the family of the prior beneficiary. Because the transfer from Son's account in the State B QSTP to Son's Program Account is not a transfer to a new beneficiary, such transfer does not meet these requirements, and the amount of this Nonqualified Distribution will be included in the gross income of Account Owner. Because amounts contributed to State B's QSTP are not deductible under the Statute, no portion of the funds in Son's account in the State B QSTP are Deducted Contributions. Therefore, only the earnings portion of the distribution will be included in Account Owner's Missouri gross income.

When an amount is transferred from one QSTP to a Program Account such that it is a rollover, there is no deduction because there is no contribution there has only been a rollover. However, when an amount is transferred from one QSTP to a Program Account such that it is not a rollover and therefore is a Nonqualified Distribution, there is a deduction because there has been a contribution to a Program Account.

Question 14-4: Will any portion of the amount transferred from the QSTP of State B to the Program Account of Daughter be included in the gross income of Account Owner, Son or Daughter for Missouri income tax purposes?

Conclusion: The rollover to Daughter's Program Account will not result in any amount being included in the gross income of Account Owner, Son or Daughter for Missouri tax purposes.

Legal Analysis: Under Section 529, earnings on contributions in State B's accounts are not included in the federal gross income of Account Owner or Son for federal income tax purposes until a distribution is made from the account. Under Code Section 529(c)(3)(C)(i), qualifying rollovers are not includible in federal gross income. Because these earnings and rollovers are not included in the federal gross income of Account Owner or Son, under Section 143.121, RSMo, earnings in State B's QSTP will not be included in the gross income of Account Owner or Son for Missouri income tax purposes, as they accrue, and qualifying rollovers will not result in Missouri gross income.

The proposed Treasury Regulations under Section 529 and the Temporary Regulations state that a transfer is only valid as a rollover if, in addition to being a timely transfer to a QSTP account, the transfer is made to a new beneficiary who is a member of the family of the prior beneficiary. The transfer from Son's account in the State B QSTP to Daughter's Program Account meets these requirements, and no amount of such transfer will be included in the Missouri gross income of Account Owner, Son or Daughter.

SITUATION J: ACCOUNT OWNER, AN INDIVIDUAL NONRESIDENT OF MISSOURI, ESTABLISHES A PROGRAM ACCOUNT FOR BENEFICIARY, WHO IS ALSO A NONRESIDENT OF MISSOURI.

Question 15: Will Account Owner and Beneficiary be subject to Missouri tax on the income they derive from the Program Account?

Conclusion: Account Owner and Beneficiary will not be subject to Missouri tax on the income they derive from the Program Account.

Legal Analysis: Ordinary principles of Missouri income taxation for Missouri nonresidents under Section 143.041, RSMo, will apply to the Missouri income taxation of the Program Account. Under that Section, a nonresident's Missouri tax is computed using a ratio of income derived from sources in Missouri and income derived from sources in other states. Under Section 143.181, RSMo (Missouri nonresident adjusted gross income), because income derived from the Program is income derived from intangible personal property, such income will not constitute Missouri source income for Account Owner or Beneficiary. Accordingly, as nonresidents of Missouri, Account Owner and Beneficiary will not have Missouri source income from the Program Account. Section 143.181.3, RSMo.

Any income imposed by the state of residence of Account Owner and Beneficiary would be determined under the laws of the state in which Account Owner and Beneficiary were residents for such state's income tax purposes.

SITUATION K: ACCOUNT OWNER, WHO IS A PART-YEAR RESIDENT OF MISSOURI AND A PART-YEAR RESIDENT OF STATE C, ESTABLISHES A PROGRAM ACCOUNT FOR BENEFICIARY, WHO IS ALSO A PART-YEAR RESIDENT OF MISSOURI AND A PART-YEAR RESIDENT OF STATE C.

Question 16: Will Account Owner and Beneficiary be subject to Missouri tax on the income they derive from the Program Account?

Conclusion: Income distributed to Account Owner or Beneficiary from the Program Account during a period of residence in Missouri within a tax year will be Missouri source income and subject to tax by the State of Missouri as described above, in response to Questions 1-14. Income distributed to Account Owner or Beneficiary from the Program Account during a period of nonresidence in Missouri within a tax year will not be Missouri source income as described above, in response to Question 15.

Legal Analysis: Ordinary principles of Missouri income taxation for part-year residents of Missouri under Section 143.051, RSMo, will apply to the Missouri income taxation of the Program Account. That Section provides that the Missouri adjusted gross income for a part-year resident consists of all items that would have determined the taxpayer's Missouri adjusted gross income during the taxpayer's taxable period as a resident of Missouri (as if that period was a full tax year) and all items that would have determined the taxpayer's Missouri adjusted gross income during the taxpayer's taxable period as a nonresident of Missouri (as if that period was a full tax year). Income from the Program Account is taxable to Missouri residents, as described in the responses to Questions 1-14 above, and is not considered Missouri source income for nonresidents, as described in response to Question 15, above. Accordingly, whether Account Owner and Beneficiary are taxed by the State of Missouri on earnings from the Program Account will depend on whether they are residents of Missouri at the time that income from the Program Account is distributed to them.

TAX EXEMPT STATUS OF THE PROGRAM

Question 17: Will the assets and income of the Program, including amounts held on behalf of Account Owners and Beneficiaries under the Program, be exempt from Missouri tax?

Conclusion: The assets and income of the Program, including amounts held on behalf of Account Owners and Beneficiaries under the Program, will be exempt from Missouri tax.

Legal Analysis: Section 166.435.1 of the Statute states, "The assets of the savings program held by the board and the assets of any similar plan qualified pursuant to Section 529 of the Internal Revenue Code and any income therefrom shall be exempt from all taxation by the state or any of its political subdivisions." In addition, the State provides that the assets of the Program, "shall at all times be preserved, invested and expended only for the purposes set forth in this section [Section 166.440] and in

accordance with the participation agreements, and no property rights therein shall exist in favor of the state." Statute, Section 166.440.

REPORTING REQUIREMENTS OF PROGRAM

Question 18: What are the Missouri tax reporting requirements of the Program?

Conclusion: The Program Manager is to at least annually issue a statement to Account Owner reporting the balances, both contributions and earnings, and itemizing all transactions, including but not limited to contributions, qualified distributions, nonqualified distributions and penalties, of each Program Account. The statement at the least must explicitly itemize the contributions the Account Owner has made during the taxable year. The Program Manager is to issue form 1099s to all distributees as required by federal law with a copy of all such form 1099s being filed with the Department of Revenue. The Program Manager is to issue a duplicate of such forms 1099s to the Department of Revenue. The Program Manager is to issue all other statements, forms, etc., as the Department of Revenue from time to time may deem necessary for compliance with Missouri Statutes.

Legal Analysis: Section 166.435.1 of the Statute authorizes a subtraction of up to \$8,000 for contributions to Program Account(s). Section 143.971, RSMo, provide the director of revenue may prescribe the form and contents of any document required to be filed under the income tax law. The Program Manager must issue a statement that sufficiently identifies the contributions so as to verify the amount of contributions by an account owner. Section 166.435.2 of the Statute provides (i) the earnings portion, and (ii) the contributions portion of Nonqualified Distributions are an addition in determining Missouri adjusted gross income of the account owner. Thus, a duplicate copy of the statement, from 1099, etc., which reports such information to an account owner must be sent to the Department of Revenue. Such notice must contain sufficient identifying information, including but not limited to an account owner's name, address, social security number or tax identification number, period, dollar amount of contributions and distributions, penalty amounts and identify the source components of all distributions as to earnings portion and contributions portion.

The notice must also identify any excess contributions for any Beneficiary. The total net contributions that may be made to Program Accounts for the same Beneficiary shall not exceed the lessor of \$100,000 and the maximum amount permitted for the Savings Program to qualify as a QSTP pursuant to Code Section 529. Code § 529(b)(7); Section 166.420.3 of the Statute. Contributions for any Beneficiary shall be rejected or if accepted in error shall be returned to the account owner. Any such rejection or return of such excess contributions to an account owner shall be an addition to the Missouri adjusted gross income of the account owner. Thus, the statement from the Program Manager must sufficiently any excess contributions, both those, which are rejected, and those, which are returned by the Program Manager.

This letter ruling is binding upon the Department of Revenue with respect to the Applicant for three (3) years from the date of this letter and is subject only to statutory changes by the General Assembly and to changes in the interpretation of law by the courts or administrative tribunals. If a change occurs, the taxpayer who relies upon an outdated interpretation may be subject to additional taxes, interest and penalties, which may be imposed prospectively from the date of the change. For this reason, the interpretation set forth above should be reviewed on a regular basis. Please not that any change in or deviation from the facts as presented will render this ruling inapplicable.

Should additional information be needed, please feel free to contact the Office of General Counsel, Post Office Box 475, Jefferson City, MO 65105-0475 (telephone 573-751-4413), or me.

Sincerely,

Quentin Wilson

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